

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

United States of America,

Plaintiff,

v.

Western Electric Co., Inc. and
American Telephone and
Telegraph Company,

Defendants.

Civil Action No. 82-0192 (HHG)

**RESPONSE OF LDDS WORLDCOM TO MOTION OF THE UNITED STATES
FOR A MODIFICATION OF THE DECREE TO PERMIT A LIMITED TRIAL
OF INTEREXCHANGE SERVICE BY AMERITECH**

WorldCom, Inc. d/b/a LDDS WorldCom ("LDDS WorldCom"), 1/
respectfully submits its comments in response to the April 3 motion of the United
States to modify the decree in this case to permit Ameritech to provide interLATA

1/ WorldCom, one of the nation's four largest long distance companies, recently changed its corporate name from LDDS Communications, Inc. This action was taken in part to reflect the significant growth in the company and its recent acquisition of WilTel, Inc. and IDB Communications, Inc.

service from limited geographic areas on an experimental basis. 2/ These comments also respond to the memorandum filed by the Department on May 1 in support of its motion. 3/

As discussed below, LDDS WorldCom supports the Customers First experiment, with certain modifications; we agree that a carefully-structured trial could provide useful information regarding the conditions that might support a more competitive local exchange market in the future. LDDS WorldCom, however, believes that the proposed order here leaves important issues unresolved, and consequently could result in substantial harm to interexchange competition. Specifically, the proposed order should be granted only if it is modified: (1) to limit Ameritech to the provision of local and long distance service together only through the separate subsidiary; and (2) to require the Ameritech operating company to provide tariffed wholesale local exchange products on a nondiscriminatory basis, for use in the provision of retail services by both the Ameritech separate subsidiary and its competitors.

2/ Motion of the United States for a Modification of the Decree to Permit a Trial, Supervised by the Department of Justice and the Court, in which Ameritech Could Provide Interexchange Service for a Limited Geographic Area, with Appropriate Safeguards, when Actual Competition and Substantial Opportunities for Additional Competition in Local Exchange Service Develop (April 3, 1995); Preliminary Memorandum of the United States in Support of Motion (April 3, 1995) ("DOJ April 3 Memorandum").

3/ Memorandum of the United States in Support of its Motion for a Modification of the Decree to Permit a Limited Trial of Interexchange Service by Ameritech (May 1, 1995) ("DOJ May 1 Memorandum").

INTRODUCTION AND SUMMARY

Like all interexchange carriers, LDDS WorldCom has a direct interest in the conditions under which Ameritech might be allowed to provide interLATA service. We have participated actively throughout these and other MFJ proceedings. In particular, we have been parties to the consideration of the "Customers First" plan before the Illinois Commerce Commission, the Justice Department and the Federal Communications Commission. We view this matter as of the greatest importance, both to the health of interexchange competition in the Ameritech region, and to the future competitiveness of the telecommunications industry generally.

The proposed order appears to rest on the view that developing competition in the local exchange, together with certain safeguards, have the potential to eliminate the decree's underlying concern about BOC control over essential network facilities. Such a finding would be necessary to any decree modification. There is no need to remind the court that the very premise for divestiture was AT&T's use of its local network to discriminate against competitors.

But as we show in these comments, even if Ameritech meets the conditions laid out in the proposed order, and even if some local competition develops, Ameritech's competitors *still* will depend on access to and resale of the BOC's local network facilities in order to compete. The local exchange competition contemplated in the Department's memorandum will not significantly affect Ameritech's ability to discriminate in the price and terms of access to its local network, nor diminish significantly the dependence of BOC competitors on that network.

The Court should recognize that few if any firms will be able to duplicate the ubiquitous Ameritech network, even in the long term. Certainly such

network duplication cannot be a prerequisite to competition with Ameritech. ^{4/} Divestiture has been a success because it has allowed many new carriers to enter the long distance market quickly and easily without having to replicate the extensive, ratepayer-financed, Ameritech local network. The future competitiveness of the industry depends on the preservation of the core decree requirement: that BOCs permit use of their unique local facilities network by others on a nondiscriminatory basis.

This problem of BOC discrimination will not go away anytime soon; if anything it will grow more serious. Today the BOCs control local network facilities that are essential to competitive long distance service. But one must recognize that those same BOC local network facilities also will be essential to the provision of competitive local service if such competition is to develop in the future.

Put another way, BOCs still will be able to discriminate in the rates and terms they charge others for most wholesale access services used in the provision of retail long distance. The Court should recognize that even if limited competitive local exchange service alternatives develop for end users, this does not create true access competition to Ameritech. Access customers (competing long distance companies) still will have to purchase access from Ameritech to reach each and every customer served by an Ameritech local loop, just as they do today. They will not have the option, as a practical matter, of purchasing access to the customer from someone else.

^{4/} LDDS WorldCom agrees with the Department that facilities-based local competition is important to the eventual erosion of BOC market power. See DOJ May 1 Memorandum at 19. But economies of scale in the local market are such that it is unreasonable to expect (and inefficient to require) multiple carriers to deploy multiple networks. This matter is discussed further below.

But BOCs also will be able to damage competition by discriminating in the wholesale rates and terms they charge others to use the exchange network to provide local service. The Customers First plan sets the stage for a world in which competition for many customers will be on a full-service, “one-stop-shopping” basis. Ameritech will be able to serve this market immediately using wholesale “carrier’s carrier” interexchange products, priced on a competitive basis, offered by several competing IXC’s (including LDDS WorldCom, which operates a nationwide fiber network designed to provide wholesale IXC services to interLATA retail carriers). Yet if today’s IXC’s want to provide similar “one-stop-shopping” services, they must deal with Ameritech to obtain local wholesale network products. The BOC therefore controls the level of competition in the overall communications marketplace.

In these circumstances, as the Court evaluates the proposed order here, it must consider whether that proposed order reasonably can be expected to prevent discrimination by Ameritech against its potential competitors in the pricing of its dominant local network resource with respect to use of that network for both (a) wholesale interexchange access used in the provision of retail long distance services (the traditional decree concern) and (b) wholesale local exchange service elements used to provide retail local services (the new area of competition). Consideration of both potential forms of discrimination is entirely appropriate under the decree because, in a one-stop shopping world, Ameritech would have every incentive to use discrimination in wholesale local exchange pricing to distort competition in both the long distance and local markets.

LDDS WorldCom has serious reservations regarding the ability of regulators, no matter how well-intentioned, to prevent discrimination in these two areas. As a result, much will depend upon the quality of safeguards contained in structural rules. The proposed order by no means addresses all of the concerns that

LDDS WorldCom has identified to the Justice Department with regard to discrimination. ^{5/} Nevertheless, we agree that a carefully-structured experiment could provide useful information to guide future decisionmaking. LDDS WorldCom in particular supports two critical elements of the proposed order and the accompanying memorandum. First, the proposed order recognizes the importance of non-facilities-based entry into the local market. ^{6/} Second, the proposed order requires Ameritech to establish a separate subsidiary for provision of interLATA services, and prohibits many joint activities. ^{7/} Both of these features of the proposed decree modification are critical.

That being said, however, LDDS WorldCom believes the proposed order must be strengthened to further limit the BOCs' practical ability and incentive to discriminate in the pricing of access and wholesale local exchange service. LDDS WorldCom urges the Court to make the following clarifications and modifications to the proposed order ^{8/}:

(1) Permit Ameritech to provide local and interLATA services together only through the interLATA separate subsidiary.

- Ameritech-IX would operate on the same basis as any unaffiliated IXC that seeks to provide local services. The Ameritech interexchange subsidiary would buy wholesale use

^{5/} See, e.g., Letter from Linda L. Oliver to Willard Tom; March 31, 1995; Letter from Peter A. Rohrbach to Robert Litan, January 10, 1995; Letter from Peter A. Rohrbach to Richard L. Rosen, May 26, 1994.

^{6/} Proposed Order, paragraph 9(c). See also DOJ April 3 Memorandum at 6; DOJ May 1 Memorandum at 19.

^{7/} See Proposed Order, paragraph 20.

^{8/} See Attachment A for text of recommended revisions to the proposed order.

of the local network from Ameritech-local and resell it for retail interexchange and local services.

- Ameritech-local would be the service provider only if the customer is buying only local or local/intraLATA service from Ameritech.

(2) Require Ameritech to tariff wholesale local exchange service products, and provide all necessary operational support systems, on a nondiscriminatory basis.

- These products are necessary whether or not Ameritech chooses to sell local and long distance together.
- These products must be “mature” before Ameritech is allowed to provide interLATA services. That is, correct pricing and provisioning must be in place and shown effective.
- Upon interLATA entry, Ameritech-IX can then purchase and resell this same local service in “one stop shopping” configurations.

Together these changes still leave open the question whether Ameritech will be able to discriminate unreasonably in favor of itself and against competitors requiring the use of its network. But for purposes of this experiment, they provide important safeguards given the weaknesses of traditional regulation. Ameritech would have additional incentives first, to make a realistic, commercially feasible wholesale local exchange service offering available, and second, to price its carrier offerings -- including its wholesale local service offerings -- on a nondiscriminatory basis.

These matters are discussed in more detail below.

I. AMERITECH'S COMPETITORS WILL CONTINUE TO DEPEND UPON USE OF THE BOC'S LOCAL NETWORK TO PROVIDE SERVICE.

The proposed order takes many steps aimed at opening up the local market to competition. These steps are important, and LDDS WorldCom hopes that they will be successful in encouraging the development of competing local exchange network facilities. ^{9/} However, the Justice Department does not predicate the proposed order on the likelihood that many parties will deploy overlapping wireline local networks. It therefore is crucial to understand how the Ameritech local network -- a network that already is sized to and does transport and switch virtually every local and long distance call today -- will remain an essential facility for the foreseeable future. With that foundation the Court can evaluate whether the proposed order contains adequate safeguards against discrimination by Ameritech in the terms under which it makes that network available to competitors and potential competitors.

A. Local Service Competition Will Not Eliminate Ameritech's Bottleneck Control of Interexchange Access.

The Department's motion rests in large part on the following premise: local exchange competition will lead to access competition, and thereby help prevent Ameritech from discriminating in the provision of access service to its interexchange competitors. But this premise is inherently flawed. Interexchange

^{9/} Ameritech is required to take a number of steps under the proposed order that could potentially lead to the development of competitive local exchange service to end users. In WorldCom's view, however, few, if any new firms are likely to find it economical to duplicate the ubiquitous Ameritech wireline local exchange network, even in the long run. As a result, competitive local exchange facilities are a more distant and problematic goal. Local service competition will depend on use of the Ameritech network to a great extent -- if not completely for many carriers.

carriers will not have competitive choices for access providers even if there is more than one wireline loop provider available to end users.

It is important not to equate local service competition with access competition; they are not the same thing. Even assuming that a new network is constructed to duplicate Ameritech's local network, the resulting competition for the local service business of end users will not of itself create competitive pressure on the rates for switched access that interexchange carriers must pay, except with respect to certain elements of the interoffice transport. ^{10/} It is important to recognize that only a small proportion of LEC revenues relate to dedicated access -- the market where competition exists today. The majority of LEC revenues is tied to control of the local loop over which a customer receives service.

But it is the end user, not the interexchange carrier, who controls the choice of loop provider and hence decides who the IXC must pay for access to that customer. This point is demonstrated in the diagram at Attachment B. Assume, for example, that 5% of end users in the Chicago LATA subscribe to a new local exchange carrier, substituting that carrier for Ameritech. In that case Ameritech still will have bottleneck control over access to each of the remaining 95% of end

^{10/} At most, interexchange carriers will have competitive choices for interoffice transport services. Even there, however, competition is likely to be limited and to develop unevenly, creating great incentives for Ameritech to discriminate among its access customers in the pricing of access transport services. And as we discuss more fully below, Ameritech is already attempting to expand upon its already wide flexibility to engage in such discrimination.

users, just as it does today. 11/ Interexchange carriers such as LDDS WorldCom will remain dependent upon use of Ameritech facilities to originate services sold to those end users, and to terminate services directed to those end users. Thus, it will be just as important to prevent discrimination by Ameritech in the pricing of that access tomorrow as it is today -- indeed, it will be far more important tomorrow, given that Ameritech itself will be an interLATA service provider.

For that matter, it is worth noting in passing that the new exchange carrier itself has similar incentives. Once that carrier has successfully convinced an end user to move from Ameritech, that carrier now will control the bottleneck loop over which all other carriers must reach the end user to originate and terminate service. This presents its own regulatory problems. For example, in Maryland Bell Atlantic recently has complained that MFS is proposing access interconnection charges that simply copy Bell Atlantic's own rates (rather than offering any savings over the BOC). Bell Atlantic complains that MFS "is seeking to employ its bottleneck control over access to its end users to subsidize its end user rates . . . through charges to captive LEC and IXC customers who must use the MFS 'bottleneck' facility to terminate calls to MFS-I end user retail customers." 12/ From the perspective of an IXC, the same problem exists with respect to the charges we must pay MFS to originate service to its end user customers.

11/ Customers will make their choice of local service company based on the local rates they pay, not the access rates the local company charges IXCs. Thus, for example, Ameritech will have an incentive to keep local rates low (to compete with the cable company, for example) and cross-subsidize that service with higher access rates charged to its long distance competitors who are forced to pay to reach the customer. This disconnect between the party selecting the access line (the end user) and the party paying the access rates (the IXC) is a form of market failure -- one that makes BOC discrimination and cross-subsidization a very attractive strategy.

12/ See Letter of Bell Atlantic to Maryland Public Service Commission regarding MFS Intelenet of Maryland Tariff MD PSC No. 2, at 5 (April 17, 1995).

Our point here is not to debate how regulators should address the market power of these new local service companies. ^{13/} Our point is that local exchange competition per se does not create access competition, and therefore will not materially reduce the ability of Ameritech to exploit its dominant local exchange position to damage interexchange competition. This is true whether Ameritech provides the local loop to 100% of the customers in its region, as it does today, or to “only” 95% or 90% of them, or even less. No matter what, it will have a continuing ability to discriminate in the wholesale access charges it imposes for the use of its local network by other interexchange service providers.

B. The Ameritech Network Also will be an Essential Facility to Local Service Competition.

The proposed order also must address Ameritech incentives to discriminate in the wholesale rates it charges other carriers to use its network facilities for the provision of retail local services. For the foreseeable future, if not indefinitely, other carriers will need to interconnect with and use that network to provide local services. No carrier will have a ubiquitous, redundant network; every carrier will be dependent on the BOC.

The Justice Department Memorandum recognizes this problem up to a point. The Department states that “[s]unk costs in this industry are, in a word, gigantic.” DOJ Memo at 31. Quite so. Ameritech already has local network

^{13/} So long as the market share of these new exchange carriers is minor, this “bottleneck” will be a less important problem. Nevertheless, as states begin to develop rules for local exchange competition, they are considering policies such as requirements that these new carriers offer equal access, and rules that at least limit the new carriers to charging access rates no higher than those of the BOCs (recognizing that they have little economic incentive to charge less). In this way local service competition does not leave IXCs worse off, even if it does not lower their access costs.

facilities to every customer premise in its region. IXCs such as LDDS WorldCom have no ability to replicate that network. Ameritech already switches virtually every call in its region, whether local (between end users) or long distance (between end users and IXC points of presence). IXCs cannot materially replicate that switching investment, which carries ten times the traffic at much greater cost than interexchange switching. 14/

14/ It is useful to examine the relative switching requirements in the long distance market -- where many firms own toll switches -- with switching requirements for the local market. In 1993, for example, interLATA toll traffic totaled 54.0 billion calls. See Federal Communications Commission, Statistics of Communications Common Carriers, 1993/1994 Edition, Table 2.6 at 22. This means that the IXC switching capacity in place was sized to handle this volume, plus associated call attempts that went uncompleted. Significantly, approximately 65% of that volume was carried by AT&T, suggesting that other IXCs individually each have switching capacity sufficient to handle only a small portion of the total interLATA traffic.

Toll switching is a relatively small barrier to interLATA market entry and expansion. This is so for several reasons that do not apply to the local market as constituted today. First, and most important, interexchange "carrier's carrier" products -- interLATA wholesale products specifically designed to facilitate interLATA service, and priced on a competitive basis near wholesale cost -- permit entry and development of a long distance customer base without any switch investment at all. Second, once a traffic base is established, small IXCs can install and expand switching capacity gradually where network savings justify this investment. Third, IXC switch investment is used more efficiently than local switches. An IXC port generally is in use in connection with trunked lines a substantial part of the day. In contrast, a local service provider would need to deploy switching capacity for every line, even though typically those lines would be inactive the vast majority of the time. This makes the unit cost of toll switching much lower than that of local. Fourth, the economics of long distance service permit interexchange switches to be centralized so as to serve large geographic areas, even if relatively little traffic comes from any one area. This means that an IXC's total interexchange traffic volumes generally can support its total switch investment decisions. Relatively little switching capacity sits idle and not generating revenue for extended periods of the day. For all of these reasons, switching does not present an entry barrier to interLATA service.

But the local market is entirely different. Most important, traffic volumes differ by several orders of magnitude. We have noted that total interLATA calls in 1993

In these circumstances, local competition only can proceed if other carriers can obtain wholesale use of the Ameritech network on a nondiscriminatory basis. The proposed order would require Ameritech to make available its loops, ports and other local network facilities for use by other carriers. The Department also would require Ameritech to provide local service for resale. Collectively these actions must make non-facilities-based local service entry "commercially feasible." ^{15/}

LDDS WorldCom strongly agrees with the Department that resale competition is crucial to any elimination of the interLATA restriction. See DOJ May 1 Memorandum at 19. The Customers First "experiment" will be doomed to failure unless it begins at a point when equivalent opportunities exist for both Ameritech and interexchange carriers to compete for customers. This will be difficult to achieve in practice. Today IXC's already share every customer with Ameritech. The BOC has an existing local service relationship with every end user in its territory, dominates the intraLATA market, and participates in virtually all

were approximately 54.0 billion. But total intraLATA toll calls were 23.4 billion, and total local calls were over 444.7 billion. Id. In other words, IXC's today switch only one tenth of the number of calls switched by the LEC's.

The consequences of these switching statistics for local competition are overwhelming. First, note that LEC's already switch all local traffic and virtually all long distance traffic (because the switch provides access to interexchange networks). They already have in place the massive switching investment necessary to support this enormous traffic load. It is unlikely that this investment could be duplicated given the relative unit cost of local switching (and the low profit margins to be expected in the local service business). But in any event, as a policy matter the nation should not want a telecommunications market in which local switching investment is in any respect a precondition to provision of local service. Such a policy would limit competition and encourage inefficient and unnecessary investment.

^{15/} DOJ April 3 Memorandum at 6; DOJ May 1 Memorandum at 19.

interLATA services through access charges. During the "experiment" Ameritech will attempt to capture the remaining element of end user communications by offering interLATA service itself.

But as Ameritech attempts to displace competitive interexchange carriers and become the end user's single communications vendor, it will be crucial that IXC's have a reciprocal opportunity to oust Ameritech from its position as that customer's monopoly local and intraLATA service provider. This opportunity must be practical, both technically and economically. Theoretical opportunities to compete are not enough.

Obviously such equivalence does not exist today. There should be no debate that Ameritech already is poised to enter the interexchange market quickly and with no significant entry barriers. As mentioned, Ameritech already has an existing customer relationship with every end user in its territory. It has enormous technical, marketing, and financial resources. Moreover, interLATA entry is simple because Ameritech can quickly obtain wholesale "carrier's carrier" interexchange service at competitive prices, choosing among several different facilities-based carriers, including LDDS WorldCom. ^{16/} These bulk switched long distance products have been developed over the past decade specifically to service the resale carrier market, and they provide a substantial margin for resale. In short, Ameritech is guaranteed immediate access to a wholesale interexchange product that it can resell profitably at the retail level to its existing customer base from day one. In contrast, no IXC has an equivalent opportunity to quickly and easily enter the local service market. As discussed above, such entry will be possible only if IXC's have equivalent opportunities to resell the wholesale Ameritech network at nondiscriminatory rates.

^{16/} See Letter from Peter A. Rohrbach to Robert Litan (January 10, 1995) at 4-5.

It is here that the Department's generally excellent memorandum falls short. On the one hand, the Department rejects Ameritech's arguments that it is enough for the BOC simply to offer its local network features on an unbundled basis, noting that Ameritech can "discriminate in the provisioning or maintenance of loops or ports or in the terms of interconnection." DOJ May 1 Memorandum at 32. Similarly, the Department acknowledges that resale-based competition "requires extensive regulation to ensure that the prices, terms and conditions under which Ameritech offers the underlying service make resale meaningfully available." Id. at 19.

But on the other hand, the memorandum does not explain how such discrimination would be prevented under the proposed experiment. It will not be enough simply to prohibit discrimination by the terms of the proposed order. This Court must be sure that as a practical matter, such discrimination is unlikely to occur. We discuss this point further in the next section.

II. THE PROPOSED ORDER DOES NOT LIMIT AMERITECH'S INCENTIVE AND PRACTICAL ABILITY TO DISCRIMINATE.

LDDS WorldCom assumes that the Department intends to defer to the future any consideration of Ameritech discrimination. The Department seems to suggest that when it evaluates the Ameritech compliance plan, it will consider whether Ameritech is discriminating in the provision of either access or wholesale local exchange service elements. The Department also presumably would find such discrimination grounds for termination of Ameritech's right to provide interLATA service.

LDDS WorldCom does not necessarily oppose this process. Certainly if Ameritech is to be relieved from the decree at all, then ongoing oversight of that

carrier to prevent discrimination will be necessary. As discussed in the previous section, the Department has acknowledged as much.

Nevertheless, in evaluating the adequacy of the proposed decree modification the Court still must evaluate the ability of regulators to identify and prevent Ameritech discrimination. The weaker the tools and resources available to regulators, the more dangerous this “experiment” would be, and the more important it would be for the Court to consider additional structural safeguards as a line of defense against discrimination.

Unfortunately, the reality is that regulatory protections against discrimination are far fewer and less effective now than at the time of divestiture, when regulation was found to be inadequate to prevent discrimination. And the irony is that Ameritech, like other BOCs, is using the bare prospect of *retail* local service competition to argue for even greater deregulation of the *wholesale* access rates it charges the IXCs with whom it wishes to compete. Similarly, Ameritech is arguing that because it may face *retail* local service competition, regulators should not oversee the *wholesale* charges the BOC would impose on its future retail competitors who will be dependent, to a very large extent, on use of the ratepayer-financed local facilities network.

The further decline of regulation

As the court is well aware, the remedy of divestiture was necessary because over a period of many years it had become evident that the tools and enforcement resources available to regulators were not adequate to prevent AT&T from engaging in discrimination, no matter what the good intentions of the regulators themselves. In approving the MFJ, this Court rejected the argument that regulation could prevent the abuses that AT&T had engaged in, including

access discrimination. 17/ The Court said that “future regulatory and injunctive remedies are unlikely to be more successful than were similar efforts in the past.” 18/

Developments since that statement have proven the court more than prescient. First, technical changes in the network have actually increased the danger of discrimination. Today, in a fiber optic environment, the incremental cost of providing telecommunications services is falling towards zero. The local network costs are predominantly common, and the fundamental issue is how those costs and associated overheads will be recovered among customers and services using the common plant. Ameritech faces strong incentives to recover those common costs and overheads from the services it provides to competitors, rather than from its own retail services.

But second, regulatory oversight of how such common costs are recovered from different customers and services has largely disappeared. 19/

17/ United States v. AT&T, 552 F.Supp. 131, 163 (D.D.C. 1982), (hereafter “MFJ Decision”), aff’d mem. sub nom. Maryland v. United States, 460 U.S. 1001 (1983). See also United States v. AT&T, 524 F. Supp. 1336, 1353-57 (D.D.C. 1981) (record evidence of AT&T use of its control over local exchange facilities to impede the development of long distance competition).

18/ MFJ Decision, 552 F.Supp. at 163.

19/ The FCC has, at times, made efforts to examine the allocation of overheads when competitive issues are at stake. See Local Exchange Carriers’ Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport, CC Docket 94-97, FCC 95-200, (released May 11, 1995) (finding unlawful the overhead allocations of certain LECs in connection with virtual collocation expanded interconnection.) However, such efforts are extremely resource-intensive. Moreover, the FCC appears to be far less concerned about the potential for discriminatory allocation of overheads in connection with pricing of access transport. See, e.g., Bell Atlantic Tel. Cos., Transmittal No. 700, DA 94-369 (FCC Common Carrier Bureau, released Feb. 27, 1995) (rejecting challenges to Bell Atlantic’s discounted switched access tariff filing).

Certainly the BOCs argue that as long as they charge more than incremental cost, i.e., recover some level of common cost in a given rate, regulators should not question the BOCs' "market-based" decision to charge some customers a larger share of common costs than others. And regulators largely have agreed to move away from strict examination of costs, particularly as they abandon traditional rate of return regulation for price cap regulation. 20/

Even these protections may be eroded further. Indeed, literally within days of the filing of the proposed order here, Ameritech asked the FCC for virtually complete deregulation of interstate access pricing. 21/ It has asked the Commission to allow it to eliminate all price cap constraints on prices for transport and switching services, to file such tariffs on one day's notice, and to engage in

20/ Rate of return regulation, which governed at the time of divestiture, has now been replaced at the federal level with a price cap method of regulation that allows local telephone companies even more freedom to discriminate. See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990), erratum, 5 FCC Rcd 7664 (1990), modified on reconsideration, 6 FCC Rcd 2637 (1991), aff'd, Nat'l Rural Telecommunications Ass'n v. FCC, 988 F.2d 174 (D.C.Cir. 1993) ("FCC LEC Price Caps Order"). Price cap regulation was designed to limit overall rate levels of monopoly LECs; it does little to prevent LECs from engaging in unreasonable discrimination in access pricing, and in particular, from recovering shared network costs and overheads in a discriminatory manner. See Policy and Rules Governing Rates for Dominant Carriers, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3211 (1988). The FCC's price cap plan also began with a flawed starting point, accepting as reasonable existing LEC rates that in many instances already reflected discriminatory recovery of overheads. Furthermore, under price caps a change in rates is presumed lawful without the presentation of supporting cost information as long as the new price falls within the overall cap and any applicable basket and band limits. See FCC LEC Price Caps Order, 5 FCC Rcd 6786, 6788-89.

21/ See Update to Ameritech's Customers First Waiver Request, Federal Communications Commission, DA 93-481, filed April 12, 1995. LDDS WorldCom filed an opposition to Ameritech's request on May 16.

contract pricing. 22/ In other words, Ameritech asked the FCC for largely free reign over interstate access pricing, predicated -- curiously and disturbingly -- on the expectation that the FCC would approve the modification here. But nothing in the proposed order would prevent regulators from taking such drastic steps to eliminate any remaining regulatory oversight of Ameritech's rates. 23/

Much protection against discrimination by Ameritech will depend upon careful regulation by state utility commissions. LDDS WorldCom has great respect for these bodies, but we also recognize their resource limitations. In Illinois, Ameritech operates under a form of price cap regulation. Ameritech has argued for further deregulation that would allow it to engage in contract pricing. In Michigan, some Ameritech service prices have a regulatory ceiling while others are listed as unregulated. In the states, then, as well as before the FCC, Ameritech fails to distinguish between the competition it may come to face in the retail market and competition it does not face in the wholesale network facilities market.

In sum, the deregulatory tide, and the limited resources of government, all run in Ameritech's favor. The simple fact is that Ameritech faces less regulation to prevent discrimination than it did at divestiture, and will face even less in the future.

22/ Update to Ameritech's Customers First Waiver Request, Federal Communications Commission, DA 93-481, filed April 12, 1995, at 19.

23/ The Commission is currently conducting a review of the LEC price cap rules, and the BOCs are actively seeking significant reductions in price cap band and basket limits and the complete elimination of the new services test. In recent decisions, in fact, the FCC has indicated its view that further price deregulation logically should accompany increased local competition. Price Cap Performance Review for Local Exchange Carriers, CC Docket 94-1, FCC 95-132 (released April 7, 1995) at paras. 406-418.

Structural rules as a substitute for regulation

The point here is not, however, whether price caps or rate of return is the governing method of regulation. Rather, the question is whether *any* form of regulation is adequate to guard against discrimination, particularly if Ameritech is allowed to enter the interLATA market. Put differently, the question is whether the proposed order's guarantee of nondiscrimination in the pricing of access and other local services to competitors can be enforced, and whether this Court can be sure that Ameritech will provide wholesale local services at rates that permit "commercially feasible" entry. At a minimum, this Court should make clear that should existing regulatory mechanisms become even weaker, such a development could trigger a review by the Department or this Court of this experiment and possibly termination of the experiment.

As explained above, Ameritech's incentive and ability to discriminate in the pricing of services that its competitors depend upon will not be diminished by the arrival of new local service providers, even if competitive pressure on retail services develops. The solution cannot be found in increased regulation of BOC pricing -- which is unlikely, given present trends, and which this Court cannot require. Nor is it realistic for the Department or the Court to engage in detailed scrutiny of BOC pricing and other conditions of providing service. Indeed, the proposed order does not contemplate such scrutiny. Measures such as tariffing, equal access, nondiscrimination, and imputation requirements are only as good as the enforcement mechanisms that accompany them.

In LDDS WorldCom's view, only strictly enforced structural measures have any chance of reducing Ameritech's ability to exercise its inevitable incentives to discriminate in the pricing and provisioning of access, unbundled network components, and wholesale local services required by the carriers with which it competes. Obviously, if Ameritech is able to discriminate in the pricing and terms

of providing these inputs, it will retain the ability to impede competition in the interLATA market. As we discuss in the next section, the proposed order's structural separation and wholesale local service requirements should be strengthened to reduce the risk that Ameritech will discriminate.

III. THE COURT SHOULD STRENGTHEN THE PROPOSED ORDER TO LIMIT AMERITECH'S ABILITY TO DISCRIMINATE.

The proposed order, as defined by the Department's memorandum, requires Ameritech to file tariffs that will permit non-facilities-based entry into the local market on a "commercially feasible" basis. The proposed order also requires Ameritech to offer interLATA services through a separate subsidiary.

LDDS WorldCom views these two provisions as key to the success of this experiment. As discussed above, the availability of commercially feasible wholesale local exchange services is essential in order to permit Ameritech's interexchange competitors to enter to the local market with the same ease that Ameritech will be able to enter the interLATA market, and to provide full-service packages in competition with Ameritech. And structural separation of Ameritech's competitive operations from its local operations also has the potential to reduce the risks that underlay divestiture.

In LDDS WorldCom's view, however, the proposed order should be strengthened in two respects in order to make the wholesale service and structural separation requirements effective as a practical matter. First, the separate subsidiary requirement should be strengthened by requiring Ameritech to offer full service packages only through its interexchange subsidiary, which would purchase inputs, including local exchange service, from Ameritech's local exchange entity on the same basis as unaffiliated interexchange carriers. Second, Ameritech should be

required to create and to tariff wholesale bundled local exchange service products, in addition to unbundled loops and ports, and to provide all necessary operational support systems. We have attached recommended modifications to the proposed order to implement these two measures. See Attachment A. With these two clarifications, LDDS WorldCom is prepared to support the motion for limited decree modification, and will reserve its further concerns to the implementation process.

A. Ameritech Should Be Allowed to Provide Full-Service Packages Only Through its InterLATA Subsidiary.

As discussed in the preceding section, regulation is not adequate to prevent Ameritech discrimination. The proposed order recognizes this problem to an extent by requiring Ameritech to provide its retail interexchange services through a separate subsidiary that purchases wholesale access service from the local operating company affiliate on an arm's length basis. This structure does not eliminate the need for regulatory oversight to ensure that the Ameritech operating company does not favor the separate subsidiary in either the rates for access or the provisioning of that service. Obviously discrimination can still exist through unjustified volume discounts or other mechanisms. But separation at least minimizes the dependence on day-to-day regulation. It also sets the stage for reduced regulation of Ameritech *retail* prices, even while the BOC's *wholesale* access services remain essentially a monopoly.

These same structural tools should be used to minimize opportunities for Ameritech to discriminate in its charges for use of the wholesale local network for competitive local service. In its comments to the Justice Department on the Customers First plan, LDDS WorldCom recommended that Ameritech be required to offer retail local service through the same separate subsidiary offering long distance, buying its wholesale local service components from the BOC operating

company on an arm's length basis just as it buys wholesale access. 24/ Indeed, the simplest and least regulatory way to ensure that wholesale local service is provided on a commercially feasible basis, at nondiscriminatory rates, is to require Ameritech's own interexchange subsidiary to purchase and resell wholesale local exchange service, just as Ameritech's competitors must do (and just as it will purchase and resell interexchange access). We continue to believe that this structure is necessary to permit development of a fully competitive retail service market, and believe that the "experiment" here will demonstrate as much. It would permit market forces to structure retail telecommunications competition, while regulators focus their attention on how the BOC offers its dominant local network to its affiliate and other retail carriers.

At a minimum, however, Ameritech at least must be prohibited from engaging in joint marketing of local and long distance services without separation. That way it can be up to Ameritech to decide whether to separate as we have suggested.

The proposed order may intend this result, but it is ambiguous and susceptible to other less competitive interpretations. Ameritech might read the order to allow it to offer full-service packages to the public without purchasing and reselling wholesale local exchange service. 25/ Thus, even though Ameritech will

24/ Letter from Linda L. Oliver to Willard Tom, March 31, 1995; Letter from Peter A. Rohrbach to Robert Litan, January 10, 1995.

25/ Although the proposed order does not permit Ameritech to engage in "bundle-pricing" until another competitor is doing so, the proposed order appears to permit Ameritech's local exchange entity to offer local exchange service as part of a package that includes interLATA service, whether or not the packages are discounted. LDDS WorldCom does not address in this filing whether bundle-pricing is appropriate. The proposed order defers consideration of such issues to review of Ameritech's compliance plan. See Proposed Order at para. 10(e)-(g).

offer its interLATA services through a separate subsidiary, that subsidiary apparently need not resell local exchange service in order to provide local service as a package with interLATA service. Rather, Ameritech's local and interLATA entities apparently may provide service jointly, engaging both in packaging and bundled-pricing of packages.

The difficulty with permitting such joint provisioning of service is that Ameritech will continue to lack an incentive to price and provision its wholesale services required by its competitors in a nondiscriminatory manner vis-a-vis its own operations. Unless Ameritech's own interLATA subsidiary has to buy and resell wholesale local exchange service itself (as its competitors must do), Ameritech will have incentives to disadvantage its competitors by making its wholesale services neither economically nor practically viable.

In other words, the proposed order appears to leave Ameritech with the incentive and ability to deter other vendors from being able to offer one-stop shopping to customers on an efficient basis. The order seems to allow Ameritech-local to joint market with its own affiliate, with all the potential for discrimination and favoritism that involves. ^{26/} And the order would require Ameritech-local similarly to joint market with other IXC's, which ensures that Ameritech continues to hold customer control over the end user as it does today. But Ameritech is encouraged to discriminate in the provision of wholesale local facilities to prevent the competing carrier from itself offering a single, economical "joint" product to the

^{26/} In recognition of the danger posed by joint marketing, this court conditioned the recent grant of a blanket waiver for interLATA cellular services on separate marketing by a BOC and its separate subsidiary. Separate marketing, the court concluded, will allow customers to more readily compare a BOC's long distance offerings with the service of competing carriers, helping to prevent monopolization. See United States v. Western Elec. Co., Inc., Civil Action No. 82-0192, April 28, 1995, at 19-20.

customer, with no retail involvement of Ameritech. This one-sided result would be seriously anticompetitive.

While it is true that the Department's memorandum requires that Ameritech file tariffs that would make possible commercially feasible non-facilities-based entry, that provision is of necessity subjective and difficult to enforce. It would be far better to employ structural mechanisms to ensure that non-facilities-based entry will be commercially feasible, both as an initial matter, when Ameritech first seeks entry into the interLATA market, and on a continuing basis.

The provisions of the proposed order and Department's memorandum therefore should be strengthened to permit Ameritech to provide full-service packages only through Ameritech's interLATA subsidiary. Ameritech's local entity could still be permitted to provide local and intraLATA service to end users, as long as those end users do not subscribe to Ameritech's interLATA services. Thus, Ameritech can retain its embedded base of local customers. But if Ameritech chooses to be a customer's full-service provider, it should have to do so through its competitive subsidiary (the interLATA subsidiary). Only in that way will Ameritech be on the same footing as its competitors, who lack access to Ameritech's essential, ubiquitous local network.

The separation of Ameritech's wholesale local exchange functions from its retail functions also will create strong incentives for Ameritech to provide wholesale local service products that are "commercially feasible," and will help eliminate Ameritech's incentives to discriminate in favor of its own operations. If Ameritech is required to provide full-service packages on the same basis as its competitors, then Ameritech's own full-service subsidiary will be just as dependent upon Ameritech's wholesale offerings as Ameritech's competitors are. If Ameritech fails to create usable, correctly priced wholesale offerings, its own ability to offer full-service packages will suffer, and not just that of its competitors.